

Message Text

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ACTION EUR-12

INFO OCT-01 EA-07 ISO-00 AGR-05 CEA-01 CIAE-00 COME-00

DODE-00 EB-07 FRB-03 H-02 INR-07 INT-05 L-03 LAB-04

NSAE-00 NSC-05 PA-01 AID-05 CIEP-01 SS-15 STR-04

TAR-01 TRSE-00 USIA-06 PRS-01 SP-02 FEAE-00 OMB-01

OPIC-03 XMB-02 /104 W

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R 211413Z JAN 76

FM AMEMBASSY PARIS

TO SECSTATE WASHDC 7032

AMEMBASSY BONN

AMEMBASSY LONDON

AMEMBASSY ROME

AMEMBASSY TOKYO

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PASS TREASURY, FEDERAL RESERVE, COMMERCE

E. O. 11652: N/A

TAGS: EFIN, FR

SUBJECT: RECENT FOREIGN EXCHANGE MARKET DEVELOPMENTS

1. SUMMARY: THE FRANC HAS WEAKENED RECENTLY AS THE COMBINED RESULT OF: (A) SOBER STATEMENTS ON THE ECONOMIC OUTLOOK AND COMPETITIVENESS OF FRENCH INDUSTRY BY HIGH GOVERNMENT AND INDUSTRIAL OFFICIALS; (B) A WIDELY ANTICIPATED WORSENING OF THE TRADE BALANCE IN JANUARY AND THE COMING MONTHS; (C) SOME REVERSAL OF SHORT-TERM CAPITAL, RELATED TO BOTH (A) AND (B) PLUS THE RECENT ANNOUNCEMENT OF STRICTER GUIDELINES ON EXTERNAL BORROWING; AND (D) A SLOWDOWN IN LONG-TERM CAPITAL INFLOWS APPARENTLY RELATED TO THE TIMING OF NEW INTERNATIONAL ISSUES PARTICULARLY BY GOVERNMENT

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CONTROLLED ENTITIES. WITHIN THE CONFINES OF THE

EC "SNAKE" THE ABOVE PATTERN STRONGLY SUGGESTS AN OFFICIAL WILLINGNESS TO PERMIT SOME WEAKENING OF THE FRANC EXCHANGE RATE, POSSIBLY TO THE 4.50-4.60 RANGE.

2. CURRENT ACCOUNT TRANSACTIONS GENERALLY ACCOUNT FOR ABOUT 60 PERCENT OF TURNOVER ON THE PARIS FOREX MARKET. THUS THE RECENT SHIFT IN THE TRADE BALANCE AND THE PROSPECTS FOR CONTINUING MONTHLY TRADE AND CURRENT ACCOUNT DEFICITS ARE BOUND TO HAVE A STRONG EFFECT ON THE FRANC EXCHANGE RATE, WHICH IN TURN WILL AFFECT SHORT-TERM CAPITAL FLOWS, PARTICULARLY AS SOME OF THE 1974-75 INFLOW WAS BASED ON FRANC APPRECIATION AS WELL AS RELATIVELY HIGHER INTEREST RATES.

3. OFFICIALS HAVE TIGHTENED EXTERNAL BORROWING GUIDELINES (SEE PARIS 1229). THIS PROBABLY IS A TEMPORARY MEASURE, PARTLY REFLECTING THE DESIRE TO INCREASE DOMESTIC LENDING IN VIEW OF RECENT EASING OF INTEREST RATES PLUS A DESIRE TO SLOW MONETARY EXPANSION SOMEWHAT, AT LEAST UNTIL DOMESTIC LOAN DEMAND PICKS UP. EXTERNAL BORROWING WILL PICK UP IF AND WHEN NECESSARY TO OFFSET EXCHANGE RATE EFFECTS OF CURRENT ACCOUNT DEFICIT. SINCE GOF OFFICIALS WISH TO TIME SUCH BORROWINGS WITH THIS OBJECTIVE IN MIND, THE RECENT TIGHTENING OF EXTERNAL BORROWING INDICATES A WILLINGNESS TO LET THE FRANC RATE DEPRECIATE SOMEWHAT.

4. PSYCHOLOGICAL FACTORS HAVE BEEN ADVERSELY AFFECTED BY A SERIES OF SOBER STATEMENTS IN THE OUTLOOK FOR 1976 (SEE PARIS 1229). THE GOF INITIATED A KIND OF ECONOMIC DEBATE TIMED FOR THE ANNUAL MEETINGS OF THE PATRONAT (ROUGHLY EQUIVALENT TO THE NAM). THIS DISCUSSION HAS FOCUSED ON TWO ASPECTS: (A) THE INTERNATIONAL COMPETITIVENESS OF FRENCH INDUSTRY; AND (B) THE GLOOMY OUTLOOK FOR CORPORATE PROFITS. THE GOF APPARENTLY HOPES TO ACHIEVE SUPPORT FOR POLICIES

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COMBINING PRUDENCE AND DISCIPLINE, PARTICULARLY RELATED TO WAGE DEMANDS, GENERAL ANTI-INFLATIONARY POLICIES, AND A CALL FOR BEST EFFORTS BY ALL CONCERNED IN WHAT NOW HAS BEEN DESCRIBED OFFICIALLY AS A DIFFICULT YEAR TO COME. THE PROPOSED CAPITAL GAINS TAX IS THOUGHT BY SOME TO HAVE HAD AN EFFECT ON THE EXCHANGE MARKET THROUGH SOME REVERSAL OF LONG-TERM CAPITAL SINCE GISCARD RECENTLY INDICATED THIS MEASURE HAS HIGH PRIORITY.

5. THERE IS GROWING FEELING HERE THAT THE RECENT VERY TENTATIVE UPTURN IN THE ECONOMY MAY FLOUNDER BY MID-YEAR MAINLY BECAUSE PROFIT MARGINS ARE TOO THIN TO INDUCE INVESTMENT AND THAT FRENCH BUSINESS GENERALLY IS BURDENED BY EXCESSIVE OVERHEAD CHARGES, LARGELY RELATED TO AN LIMITED OFFICIAL USE

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EXCESSIVE LEVEL OF WORKERS GIVEN CAPACITY UTILIZATION AND VERY SERIOUS DEBT SERVICING PROBLEMS (SEE PARIS 0482 FOR DETAILS). GOF STATEMENTS RECENTLY SHOW A KEEN AWARENESS OF THIS PROBLEM BUT TO DATE NO OFFICIAL PROPOSALS TO DEAL WITH IT HAVE EMERGED. AS A PSYCHOLOGICAL FACTOR IT NO DOUBT WILL CONTINUE TO HAVE A PERVASIVE AND NEGATIVE IMPACT ON ALL FINANCIAL MARKETS, INCLUDING THE FOREX MARKET, AND AS A REAL FACTOR IT SEEMS INCREASINGLY LIKELY TO CAUSE A VERY SLOW UPTURN IN 1976. SOME SPECIFIC MEASURES TO EASE CORPORATE FINANCIAL BURDENS

IN THE COMING MONTHS SEEM LIKELY AND RECENT GOF STATE-
MENTS AND SOBER ASSESSMENTS MAY BE MEANT TO PAVE THE
WAY FOR SUCH MEASURES.
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